

Message Text

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ACTION EUR-12

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TO SECSTATE WASHDC 2763

INFO AMCONSUL BREMEN

AMCONSUL DUSSELDORF

AMCONSUL FRANKFURT

AMCONSUL HAMBURG

AMCONSUL MUNICH

AMCONSUL STUTTGART

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C O N F I D E N T I A L SECTION 01 OF 03 BONN 14800

DEPARTMENT PASS TREASURY AND FEDERAL RESERVE AND CEA

E.O. 11652: GDS

TAGS: EFIN, GW

SUBJECT: ECONOMIC POLICY VIEWS OF FRG OFFICIAL FROM
SPD CENTER-LEFT

REF: BONN 14475

1. SUMMARY. A CENTER-LEFT SPD VOICE IN THE UPPER REACHES
OF THE FINANCE MINISTRY HIERARCHY FORECASTS THAT AN FDP-
TYPE MITBESTIMMUNG BILL WILL BE PASSED IN THIS
LEGISLATIVE SESSION. HE FEELS U.S. SPOKESMEN ARE
TOO OPTIMISTIC IN THEIR ECONOMIC FORECASTS,
ALTHOUGH THE GERMAN ERRORS IN THIS REGARD WERE BASED ON
HONEST ANALYSIS. AN UPTURN IN GERMANY HAS TO COME, BUT
IF IT DOESN'T COME THIS WINTER, THERE IS NOTHING LEFT
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FOR THE GOVERNMENT TO DO TO HURRY IT ALONG. CAPITAL

MARKET PROBLEMS IN FINANCING THE PUBLIC SECTOR DEBT ARE ALREADY BEING FELT AND ARE DESTINED TO WORSEN, ALTHOUGH THEORETICALLY THIS SHOULD NOT BE THE CASE. CONSUMER SPENDING WILL LEAD THE WAY OUT OF THE RECESSION, NOT EXPORTS OR INVESTMENTS. INVESTMENT GROWTH ONLY BECOMES A PROBLEM IN THE MEDIUM TERM, SO NOTHING NEED BE DONE NOW TOWARD THIS END. UNEMPLOYMENT HAS NOT YET CREATED SOCIAL UNREST, BUT THERE IS SOME WORRY FOR THE FUTURE. A RESTRUCTURING OF THE ECONOMY IS NECESSARY TO LICK THE PROBLEMS, BUT THIS NEEDS NATIONAL PLANNING, WHICH IS LITTLE ADVANCED AND DIFFICULT TO UNDERTAKE. END SUMMARY

2. IN A WIDE-RANGING CONVERSATION WITH THE ECONOMIC/ COMMERCIAL MINISTER COUNSELOR, ASSISTANT SECRETARY MANFRED LAHNSTEIN OF THE FINANCE MINISTRY PROVIDED SOME INSIGHTS INTO A PARTICULAR VIEW OF CURRENT ECONOMIC POLICY ISSUES. THIS VIEW IS AN IMPORTANT ONE SINCE IT REPRESENTS A VARIETY OF SPD THINKING SLIGHTLY TO THE LEFT OF CHANCELLOR SCHMIDT, LAHNSTEIN, INCIDENTALLY, WAS AT ONE TIME THE PRINCIPAL ECONOMIC ADVISOR IN THE CHANCELLERY OF WILLY BRANDT. IN HIS CURRENT, STILL POLICY-LEVEL POSITION IN THE FINANCE MINISTRY HE CAME ACROSS AS THE YOUNG, AWARE, EBULLIENT AND PARTY MAN HE VERY DISTINCTLY IS.

3. LAHNSTEIN THOUGHT THAT WITHOUT A DOUBT THERE WOULD BE MITBESTIMMUNG OR CODETERMINATION LEGISLATION APPROVED IN THIS SESSION OF PARLIAMENT. HE FORESAW NO PROBLEMS WITHIN THE COALITION ON THIS ISSUE SINCE THE SPD HAD AGREED THAT IT WOULD BE THE LESS-ONEROUS-TO-BUSINESS FDP FORMULA THAT WOULD BE FOLLOWED.

4. WHEN ASKED ABOUT THE CHANCELLOR'S CURRENT VIEW OF THE US ECONOMY, ESPECIALLY GIVEN HIS PAST STATEMENTS REFLECTING SOMETHING LESS THAN ENTHUSIASM, LAHNSTEIN SAID THAT SCHMIDT WAS NOT YET CONVINCED THAT A MEANINGFUL RECOVERY WAS UNDERWAY IN THE UNITED STATES. HE WENT ON TO SAY THAT HE CANNOT UNDERSTAND THE US TENDENCY TO BE SO CONFIDENT CONCERNING THE OUTLOOK ON THE BASIS OF CONFIDENTIAL

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SUCH MEAGER DATA (THE POSITIVE REAL GROWTH IN THE SECOND QUARTER DID NOT IMPRESS HIM). WHEN IT WAS RECALLED TO LAHNSTEIN THAT SIMILAR, APPARENTLY UNDULY OPTIMISTIC FORECASTS WERE BEING UTTERED BY THE CHANCELLOR CONCERNING GERMANY EARLIER IN THE SPRING BEFORE THE ELECTIONS, HE CLAIMED THAT AT THAT TIME THERE WAS THE HONEST BELIEF THAT A RECOVERY WAS INDEED AT HAND AND THERE WAS NO POLITICKING INVOLVED IN THE GOVERN-

MENT'S POSITIVE FORECASTS OF THAT TIME.

5. THE FINANCE MINISTRY OFFICIAL NOTED THAT DESPITE THE HIGH UNEMPLOYMENT AND THE PROSPECT THAT IT WILL BE INCREASING, ORDER SEEMED TO BE PREVAILING IN LABOR RANKS. WHAT PARTICULARLY DISTURBED HIM, THOUGH, IN TERMS OF THE FUTURE DEVELOPMENTS, WAS THAT AN INCREASING NUMBER OF UNEMPLOYED WOULD MOVE FROM THE UNEMPLOYMENT BENEFIT . LEVEL ROUGHLY EQUIVALENT TO 68 PERCENT OF GROSS PAY TO

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ANOTHER SYSTEM OF COMPENSATION UNDER THE SOCIAL WELFARE SYSTEM WHICH COULD PROVIDE CONSIDERABLY LOWER LEVEL BENEFITS. THE SECOND STAGE BENEFITS WOULD SIGNIFY IN MOST CASES A SHARP REDUCTION IN THE STANDARD OF

LIVING AND THIS COULD LEAD TO A DISTURBING DEGREE OF UNREST AND DISCONTENT.

6. LAHNSTEIN THOUGHT, IN REGARDS TO THE GUEST WORKER FORCE, THERE WAS REALLY VERY LITTLE INDUCEMENT FOR MOST OF THEM TO GO HOME ALTHOUGH THEY WERE UNEMPLOYED. THIS WAS BECAUSE THE LEVEL OF BENEFITS UNDER EITHER UNEMPLOYMENT BENEFIT SYSTEM PROBABLY REPRESENTS A BETTER SITUATION THAN THEY OTHERWISE WOULD HAVE IN THEIR HOME COUNTRIES. HE ESTIMATED THAT OF THE 2 MILLION OR SO FOREIGN WORKERS 1.5 MILLION HAD TO BE CONSIDERED AS CONFIDENTIAL

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PERMANENT IMMIGRANTS IN GERMANY. HE DID NOT FORESEE ANY MEASURES BEING UNDERTAKEN BY THE GOVERNMENT THAT WOULD FORCE THE GUEST WORKERS OUT OF THE COUNTRY OR OTHERWISE DISCRIMINATE AGAINST THEM AS THIS WOULD BE MORALLY REPREHENSIBLE AND THEREFORE CONTRARY TO SPD PHILOSOPHY.

7. THE LONGER TERM SOLUTION TO THE UNEMPLOYMENT PROBLEM LIES IN THE RESTRUCTURING OF THE ECONOMY, LAHNSTEIN MAINTAINED. THERE MUST BE A GREATER DEVELOPMENT OF THE SERVICES SECTOR TO ABSORB THE INCREASING NUMBERS OF WORKERS BECOMING SURPLUS IN THE INDUSTRIAL SECTOR. THE PROBLEM IS, HE SAID, THERE IS REALLY NO PLANNING BEING UNDERTAKEN TO ATTACK THIS PROBLEM AS WELL AS OTHERS. HE FELT THAT THERE WAS A REAL NEED TO MOVE TO NATIONAL PLANNING IN THE FRG, BUT THAT THERE WERE CERTAIN DIFFICULTIES IN THIS GIVEN THE FEDERAL SYSTEM UNDER WHICH THEY OPERATE AND THE CONSIDERABLE AUTONOMY OF THE STATE GOVERNMENTS.

8. LAHNSTEIN WAS QUITE SKEPTICAL OF THERE BEING AN INVESTMENT- OR EXPORT-LED RECOVERY FROM THE CURRENT RECESSION. HE FELT THAT PRIVATE CONSUMPTION MUST BE THE PRINCIPAL ELEMENT IN BRINGING ABOUT AN UPTURN AND EXPRESSED CONFIDENCE THAT THERE WOULD BE ANOTHER "WAVE" OF CONSUMER SPENDING. HE NOTED THAT THERE IS CURRENTLY UNDER WAY, IN A SOMEWHAT SUBDUED FASHION, SUCH A "WAVE" IN THE PURCHASE OF AUTOMOBILES. WHAT IS NEEDED, HE SAID, IS SOME, AS YET, UNCLEAR, WAY OF STIMULATING THE INVESTOR TO SPEND ON A LESS RESTRAINED BASIS. HE RECOGNIZED, THOUGH, THAT THE CURRENT UNEMPLOYMENT SITUATION WAS A SERIOUS DETRIMENT TO THE CONFIDENCE NECESSARY BEFORE SUCH A BUYING WAVE CAN BE STARTED ON A MEANINGFUL SCALE. ON THE OTHER HAND, HE THOUGHT THAT THE CONSUMERS COULD BE "EDUCATED" IN A DIRECTION TOWARD STIMULATING THEIR EXPENDITURES.

9. IN REGARD TO THE FINANCING OF THE BURGEONING DEFICITS OF THIS YEAR AND NEXT, LAHNSTEIN SAID IN THEORY THERE WOULD BE NO PROBLEMS. ON THE OTHER HAND, THE PRACTICAL CONSIDERATIONS WILL MAKE IT QUITE CONFIDENTIAL

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DIFFICULT AND, IN FACT, THERE ARE CAPITAL MARKET PROBLEMS ALREADY, HE SAID. IN EFFECT, HE OBSERVED, THERE WAS "A CARTEL OF MONETARY INSTITUTIONS" WHICH ARE DECISIVE IN THE FINANCING OF THE PUBLIC DEBT. IN THE CURRENT CIRCUMSTANCES THEY SEE THAT IN VIEW OF THE LARGE PUBLIC SECTOR DEFICITS WHICH ARE PROJECTED FOR NEXT YEAR AND BEYOND, THAT INTEREST RATES ARE BOUND TO RISE. THEREFORE, THERE IS GREAT RELUCTANCE TO PICK UP GOVERNMENT PAPER AT THE CURRENT LOWER RATE OF INTEREST, HE SAID. TO PAY A HIGHER RATE OF INTEREST TO LOOSEN THE FLOW OF CREDIT TO THE PUBLIC SECTOR WOULD BE INIMICAL TO THE GOVERNMENT'S POLICIES IN THAT IT WOULD ADD TO INFLATIONARY FORCES. FURTHERMORE, HE SAID, THE FEDERAL SYSTEM IN GERMANY OFFERS PROBLEMS IN THAT THE STATES AND LOCAL COMMUNITIES ARE FREE TO ACT IN THE FIELD OF CREDIT POLICY AS THEY WISH, INCURRING DEBT AT A HIGHER RATE THAN THE FEDERAL GOVERNMENT WOULD PREFER, THEREBY COMPOUNDING THE CAPITAL MARKET PROBLEM.

10. THE FINANCE MINISTRY OFFICIAL THOUGHT THAT EVEN THOUGH THERE WOULD BE NO INCREASE IN THE RATE OF INVESTMENT OVER THE NEXT THREE YEARS, IT WOULD STILL BE POSSIBLE TO REGISTER ANNUAL REAL GROWTH RATES OF 3 PERCENT OVER THIS PERIOD. OF COURSE, HE SAID, IT WOULD NOT BE DESIRABLE TO HOLD INVESTMENT DOWN TO ZERO GROWTH, BUT IT DOES EMPHASIZE THE FACT THAT THIS IS NOT THE MOST IMMEDIATE AND PRESSING PROBLEM AS HAS BEEN URGED BY OTHERS IN HIS OWN GOVERNMENT, PARTICULARLY FROM THE

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FDP SIDE OF THE COALITION. INCREASING RATES OF INVEST-
MENT ARE A NECESSITY ONLY FOR THE MEDIUM TERM,
MAINTAINED LAHNSTEIN.

11. OUR CONTACT WAS QUITE SKEPTICAL ABOUT FUTURE
POSSIBILITIES FOR EXPORTS. IELD
HE ASSUMED THERE WOULD BE NO MOVE ON
THE PART OF THE FRG TO CONTROL THE FLOW OF IMPORTS
NOR TO STIMULATE EXPORTS BY SOME EXCEPTIONAL MEASURES .
THE FORECAST FOR THE RATE OF INFLATION WILL BE HIGHER
THIS YEAR THAN EARLIER EXPECTED, SAID LAHNSTEIN. HE
THOUGHT THAT 6 PERCENT, PERHAPS EVEN MORE, IS POSSIBLE.
HE WOULD NOT SPECULATE ABOUT NEXT YEAR, HOWEVER. WHEN
ASKED WHAT THE FRG WOULD DO IF COME NEXT WINTER UN-
EMPLOYMENT REACHES 1.6 OR 1.7 MILLION AND THERE IS STILL
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NO SIGN OF A RECOVERY IN ECONOMIC GROWTH, LAHNSTEIN
WOULD ONLY RESPOND THAT HE WAS QUITE SURE THAT SUCH A
SITUATION WOULD NOT ARISE, AND IF IT DID, THERE WAS
REALLY NOTHING LEFT IN THE MACROECONOMIC BAG OF TRICKS
TO DO. HE CITED THE LIMITING FACTORS AS BEING
THE FACT THAT THE BUNDESBANK HAD GONE AS FAR AS IT COULD
ON MONETARY POLICY, AND THAT THE CAPITAL MARKET COULD
ABSORB NO MORE PUBLIC SECTOR DEBT WITHOUT BOOSTING

INFLATION AND INHIBITING GROWTH POSSIBILITIES, SO ADDED
STIMULATIVE SPENDING OR TAX CUT MEASURES WERE ALSO OUT.
HILLENBRAND

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